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THE MALT BEVERAGE INTERBRAND COMPETITION ACT

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HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

S. 412

A BILL TO CLARIFY THE CIRCUMSTANCES UNDER WHICH TERRITORIAL PROVISIONS IN LICENSES TO DISTRIBUTE AND SELL TRADEMARKED MALT BEVERAGE PRODUCTS ARE LAWFULLY UNDER THE ANTITRUST LAWS

OCTOBER 2, 1985

Part 2

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THE MALT BEVERAGE INTERBRAND COMPETITION ACT—S. 412

WEDNESDAY, OCTOBER 2, 1985

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 3:22 p.m., in room SD-226, Dirksen Senate Office Building, Hon. Howard Metzenbaum (acting chairman) presiding.

Also present: Senator Denton.

Staff present: Kenneth Starling, chief antitrust counsel; Eddie Correia, minority chief counsel, Subcommittee on Administrative Practice and Procedure.

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

Senator METZENBAUM. The hearing will come to order. The fact that I am chairing this hearing has no relevance or significance vis-a-vis the upcoming election and is not a prediction of things to come. It is just happenstance that the chairman wants to be on the floor of the Senate having to do with a trade matter. But who can tell? Maybe things will change.

The bill to give the beer industry special treatment, that bill that we have before us today, Senate bill 412, is a bill that could have been anticipated and was anticipated by this Senator when we had the bottlers' bill. At that time, I indicated that it will not be long before the beer industry will be in asking for a special exemption.

I think that the bottlers' bill as well as this bill are classic cases of special-interest legislation. It is not needed. It would raise prices to consumers and it would hurt competition.

But because consumers' voices are not as loud as the industry's, the beer wholesalers continue to have hope that they can get this unjustified bill passed. I must confess, I cannot for the life of me understand how they got so many cosponsors on this legislation, other than the fact that they have effective lobbyists both here and back home as well.

But the reality is that passing this bill means that consumers are going to pay more money, and I have checked with my constituents; there are 11 million of them and I have not found anyone in the State who really wants to pay more for a bottle of beer.

Yet, I find my colleagues coming on as cosponsors for this bill. It is not a new issue. For almost 5 years, beer wholesalers have been trying to get special treatment under the antitrust laws so they can have a monopoly in a particular area.

They continue to demand this special treatment even though the Supreme Court has ruled that exclusive territories are lawful as long as they are not unreasonable and do not harm competition.

But the beer industry is not happy with the same standard that applies to everyone else. They want their own standard, one that will make it easier for them to eliminate price competition.

It is no accident that the beer wholesalers made their first attempt to get an exemption from the antitrust laws in the 97th Congress. It was not because there was some new development in the industry that made a special antitrust standard necessary. It was for the obvious reason, because the soft drink bottlers managed to win an exemption and the beer wholesalers decided that they should have one, too.

I am not quite certain who comes next, maybe the boozers, those who peddle liquor, maybe those who peddle rum, maybe those who peddle vodka, or maybe something else in the community.

But there are more and more people who think that we ought to come to the U.S. Congress to get an exemption from our antitrust laws who walk out of the room and go to their country clubs and say that, damn it, the Government ought to stay out of business; they ought to let free enterprise just operate the way it wants.

Well, we passed the antitrust laws so you would have free enterprise and free competition working. But now the beer industry does not want free competition. There is a good lesson here. Every time Congress opens the door a little bit, every time Congress lets the camel get its nose under the tent, you can be sure that somebody else is going to want to go under the tent with the camel as well.

As a matter of fact, I think maybe Congress ought to have more than this one hearing. I think we ought to spend some time looking at the beer wholesale industry; we could learn something. If we do, we will find some things that deserve the public's attention far more than this effort to win a special-interest exemption.

We will find that this industry is one of the most anticompetitive ones in the country. We will find that over the years the beer wholesalers have managed to lobby through State legislatures laws that protect them from competition in ways that other industries can only dream about.

These laws make this industry the opposite of the free market. These laws mean the special-interest antitrust exemption we are considering today would be even worse than the exemption Congress passed for the soft drink industry.

Here are some of the laws that protect the beer wholesalers from competition. Twenty-six States have laws mandating exclusive territories for beer wholesalers. In other words, in over half the States in this country wholesalers already have been able to win protection from competition in their areas.

Almost every State in the Union has a law prohibiting the sale of beer directly from the manufacturer to the retailer. Why? Why should not the manufacturer be able to sell directly to the retailer? Is there any public interest involved? Why do such laws stay on the books when food retailers can buy virtually every other product directly from the manufacturer?

There is not a single reason that I can think of as to why the food retailers cannot buy directly from the manufacturer if the

manufacturer is willing to sell. But it is because of these laws on the State books that beer wholesalers will continue to be the middlemen, taking profits and raising prices to the consumer, even if they could not survive in a free market.

Other State laws require wholesalers to post their prices so that other wholesalers can see what their competitors are charging.

Now, who do you suppose supports these laws? You bet—the wholesalers themselves who want a way to make it easier to coordinate prices and to keep an eye on the competitor who might choose to start charging lower prices.

But that is still not all the ways this industry has managed to avoid the rules of the free market. In almost all States, you have to get a license to be a beer wholesaler. These license boards can be used to keep out competition and play politics instead of protecting the health and safety of the public.

There are laws requiring retailers to pay wholesalers in cash, laws requiring the prices retailers have to pay, and on and on. In other words, the beer wholesale industry does not operate by the rules of free competition; it operates by the rule of protection from competition. It operates by the principle of talk free enterprise for everyone else, but try to get laws to reduce free enterprise for yourself.

Now, since it is not satisfied with all the laws at the State level that protect it from competition, it has come to the Congress for special treatment under the Federal laws. I say to you in the industry that I will do my best to make sure that does not happen.

We have three witnesses with us today who asked to be heard: former Senator Birch Bayh, from the firm of Rivkin, Radler, Dunne & Bayh. Senator Bayh, we will be very happy to hear from you.

We have Priscilla Budeiri, Public Citizen Congress Watch, on behalf of Public Citizen and the Consumers Union, and we have Dr. Richard Lipsky, public policy consultant for the Empire State Beer Distributors Association, of Bellrose, NY.

Senator Bayh, we will be glad to hear from you, and then we will be glad to hear from the other two witnesses immediately thereafter. Senator Bayh, I hope you know what we do so often here; we ask our witnesses to confine themselves to a rather limited time—I would hope about 7 minutes, and then your entire statement would be included in the record.

I want to say that I think it is appropriate that I limit you to 7 minutes because when I tried to stop you in passing the bottlers' bill, you filibustered me from getting a chance to make an amendment. You had more than adequate time on that occasion, so I feel particularly pleased that I have a chance to limit you at this moment to 7 minutes.

STATEMENT OF HON. BIRCH E. BAYH, JR., RIVKIN, RADLER, DUNNE & BAYH, WASHINGTON, DC

Mr. BAYH. Mr. Chairman, I think you are in a stronger position to control my time now than I was to control yours back then. [Laughter.]

Senator METZENBAUM. You did well, you did well.

Mr. BAYH. Certainly, I am willing to abide by your rules and regulations. I feel a bit nostalgic here in these environs and I wonder how it is going to feel on this side of the table, having spent a number of hours side by side with you and my other colleagues on the other side of the bench there.

I am happy to respond to the invitation to appear before the committee and to present testimony comparing the substance and circumstances surrounding the passage of the Soft Drink Interbrand Competition Act, which you referred to earlier, and to then look at similar aspects, as I am aware of them, as they affect the malt beverage interbrand competition legislation before the committee.

Before proceeding, I think from the standpoint of public knowledge I should inform you and the committee that my law firm has been working with the Food Marketing Institute on a variety of food-related issues, and recently they asked me to make a comparison of the various factors affecting the malt beverage legislation with the soft drink legislation.

FMI has opposed this legislation for a good, long period of time, but I must confess that that request caused me to do a good deal of research and to refresh my memory as it related to circumstances and events which transpired several years ago.

I would like to emphasize more importantly that the comparison and assessment of these two pieces of legislation which I am prepared to make for the committee is based upon my own independent judgment of the facts available in the record which is open for all of us to look at.

I do not intend to discuss the pros and cons of the malt beverage legislation. Instead, as the author and principal Senator sponsor of the soft drink legislation, I shall attempt to compare, or perhaps it is more appropriate to say contrast, the circumstances surrounding the consideration of these two pieces of legislation.

I am certain that nothing I say will convince my distinguished friend and former colleague from Ohio of the merits of the soft drink legislation. However, I think it might be helpful to at least put in the record the environment and circumstances which caused me, as a strong supporter of antitrust legislation, to feel that this exception was important and could be dealt with from a conscience standpoint despite my concern for antitrust provisions.

To the extent that the supporters of the malt beverage bill advocate its passage on the grounds that it is just like the soft drink bill, I should note, with all respect for the good intentions of the supporters, that there are significant differences between the two industries and the circumstances which prompted congressional consideration of the legislation.

Specifically, the structure of the two industries is different. The economic impact of the two industries' local facilities is different. The constitutional authority and precedent for regulating the two industries is different. The legal environment in which the malt beverage industry is operating today is much different than the legal environment which confronted the soft drink industry in 1980.

Lastly, if one looks at the record, it is rather clear that the most fervent supporters of the soft drink bill, a big majority of Congress,

did not intend for the soft drink legislation to be utilized as a precedent for any subsequent legislation.

Perhaps it would be helpful to just touch quickly in a more elaborate fashion on these five particular points. Looking at the different structures, it is important to note that the soft drink products now are mixed, bottled and distributed by over 2,000 production facilities throughout the country.

More importantly, a large majority of soft drink production facilities are owned and operated as independent small businesses. In the malt beverage industry, the final product is produced in a relatively few, large industrial facilities, all of which are owned and operated by parent companies of the various brands of malt beverages.

Closely related to this is the different economic impact. Each soft drink bottling facility requires sufficient capital, management and manpower to actually create and operate a production facility, as well as sufficient resources to distribute soft drinks once they are manufactured.

The local distributors of malt beverages, on the other hand, require only the latter—the capital necessary to manage, store and distribute products in the wholesale market.

The different constitutional authorities for regulation—without going into a great deal of detail, the 21st amendment to the U.S. Constitution specifically delegates the power to control alcoholic beverages to the individual States. I do not need to go into that in any detail.

Each State does require malt beverages to be subjected to a three-tier regulation that the chairman referred to a moment ago.

I should touch on the different legal environments because I think that was the compelling factor as far as I was concerned as a Senator that distinguishes the two pieces of legislation.

As you recall, in 1971, the Federal Trade Commission began proceedings against the soft drink companies, alleging that there was a violation of antitrust law. Comprehensive hearings were held, and the administrative law judge who held these hearings and heard the evidence ruled that the territorial provisions were not an undue burden on competition and therefore were not illegal.

After extensive review and oral arguments, the Commission, on a 2-to-1 vote, overruled the man who had heard the evidence and did say that the territorial provisions constituted an unreasonable restraint of trade. This decision was made in 1978, almost 7 years after the initial proceedings against the industry, and immediately they took an appeal, as you may recall, of the FTC decision to the U.S. Court of Appeals.

That was the legal setting that I faced as a Senator that caused me to introduce the soft drink bill on March 8, 1979. I cannot speak for other Members of the Senate at that time. However, in my judgment the compelling factor was here you had an agency of the Federal Government for 8 years vigorously pursing and continuing to pursue a policy which was designed to change the way the soft drink industry had operated for three-quarters of a century.

A change in the status quo which was to be brought about by a Federal agency would have led to widespread disruption and dislocation, which the agency was willing to accept, and the evidence

was very unequivocal to that effect. I do not see any similar FTC threat posed to the malt beverage industry today.

I would like to call attention to the specific language of the hearings and of the debate on the floor in both the House and the Senate. There is no question that all of us who were in a leadership role made it very clear that no precedent was to be established.

I hate to rely on myself as a lead person in the floor debate, but as the chief sponsor and the guider of that legislation, that was my role. If you look at the opening statement that I made on the floor and if you look at the opening statement that I made at the hearings, there is no question that we say, and everybody said who supported that legislation, this was to be no precedent for other legislation; that we had a unique set of circumstances.

I might like to ask you to put in the record—the chief Republican supporter of the soft drink bill was our distinguished friend from Mississippi, Senator Cochran, and he emphasizes the uniqueness of the soft drink industry and that no precedent is to be established.

Having said that, Mr. Chairman, I think the trapdoor is going to fall here shortly and I should cease and desist before I hit the floor.

Senator METZENBAUM. We will include your entire statement in the record.

We appreciate your comments, Senator Bayh. You are in a good position to analyze the distinction between the soft drink bill and the beer bill.

Let me ask you, How would you compare the degree of concentration at the local level in the beer wholesale industry and the soft drink bottling industry?

Mr. BAYH. I have not had a chance to study that in the time I have been involved in the revisitation of this issue. I do recall that the Justice Department, in the recent study that they conducted and in their testimony before this committee, as I recall reading it, suggested that there was substantially more concentration and less competition at the local level in the malt beverage industry than there was in the soft drink industry. I have not had a chance to study that myself personally.

Senator METZENBAUM. Are you familiar with the degree of State regulation in the beer industry as compared to the degree of regulation with respect to the sale of soft drinks? I gather there is practically none as far as the sale of soft drinks is concerned.

Mr. BAYH. As I listened to the chairman's opening remarks, I think he stated them very well. There is no State prohibition to getting into the business and to owning up and down the line of distribution and consumption in the soft drink industry.

There is a three-tier prohibition in the beer industry where one producer cannot own a wholesaler and a wholesaler cannot own a retailer and, of course, each State determines whether you can get into the business or not and in what manner.

Senator METZENBAUM. What is your general feeling about the effect on consumers and the price that consumers pay for beer if this legislation passes?

Mr. BAYH. Well, I really do not know. It seems to me, as I try to compare as best I can where the soft drink industry was and where it wanted to go so it would not have a lot of hometown industries

bankrupt, the malt beverage industry already has that, and more, in 27 States that require territorial franchises, and 22 States can if they want to. Only in Indiana do you have a sort of freewheeling competition.

I do not see how the passage of this legislation is really going to give them that much more. But to the extent it does change the burden of proof as far as antitrust laws at the Federal level are concerned, I assume that is why they are actively pursuing it.

Senator METZENBAUM. You were formerly chairman of the Antitrust Committee?

Mr. BAYH. I was a member, Mr. Chairman, not the chairman.

Senator METZENBAUM. Your voice was certainly loud and clear on many of these issues, but generally speaking, putting aside the soft drink bill, is it not your experience and your view that where there is less free competition, higher prices are the normal result by reason of that lack of competition?

Mr. BAYH. Indeed, that is the case. Frankly, that reason, although I never could get my friend from Ohio to see the wisdom of this line of reasoning—in looking at the record compiled by the FTC, it convinced me that the impact of the FTC ruling would lead to lesser competition rather than increase it because of the unique characteristics of the production and distribution features of the soft drink industry.

You had a number of hometown bottlers that, if they were denied access to the major Safeways and Kroegers and the major purchasers of soft drinks by taking away the territorial rights that they had, they would really go out of business. Thus, there would be less competition; there would be less service.

For that reason, I could, in good conscience, despite my strong feeling that competition is good for the consumers and good for the country, support this bill, while some, in good conscience, like yourself felt it would lessen competition. In my judgment, the soft drink bill would lead to more competition if it passed than would otherwise be the case.

A situation existed there. Emphasize, if I may, that you had—it is one thing if somebody goes out of business in the free enterprise system if they cannot cut it. It is another thing to have an agency of the Federal Government ignoring the evidence presented by the person who took the evidence and saying that they are going to destroy a precedent that has existed for 75 years.

You have an arbitrary Federal decision that is imposed upon an industry which, in my judgment, is quite a compelling reason to get involved with the soft drink bill. You do not have such a sword of Damocles hanging right now over the other industry.

Senator METZENBAUM. Thank you very much, Senator Bayh. It is always good to see you and good to have you back with us today; if not on this side of the table, at least we are glad to have you with us on that side of the table.

Mr. BAYH. Mr. Chairman, I appreciate your courtesy. I find that I am just as nervous on this side of the table as I was when I was sitting on the other, so thank you.

Senator METZENBAUM. You were one of our very distinguished members and we are sorry to have lost you, but glad to have you back today.

[The statement follows:]

STATEMENT BY THE HONORABLE BIRCH BAYH

Committee on the Judiciary

October 2, 1985

Mr. Chairman, I am happy to respond to your invitation to appear before the Committee to present testimony comparing the substance and circumstances surrounding the passage of the Soft Drink Interbrand Competition Act adopted by Congress in 1980 with similar aspects of the Malt Beverage Interbrand Competition legislation which is now before the Committee.

Before proceeding, I should inform you that my law firm has been working with the Food Marketing Institute on a variety of food-related issues. Recently, FMI requested that I study the similarities or differences between the Soft Drink and Malt Beverage legislation. FMI has vigorously opposed the Malt Beverage legislation for some time. However, the FMI request required me to review the legislative record and to refresh my memory relative to circumstances and events which transpired several years ago. Most importantly, I want to emphasize that the comparison and assessment of these two pieces of legislation is based upon my own independent judgment of the facts available in the record which is open for all to review.

Mr. Chairman, I do not intend to discuss the pros and cons of the Malt Beverage legislation. Instead, as the author and principal Senate sponsor of the Soft Drink legislation, I shall attempt to compare -- or perhaps it is more appropriate to say contrast -- the circumstances surrounding the consideration of these two pieces of legislation by the Congress.

To the extent that the supporters of the Malt Beverage bill advocate its passage on the grounds that it "is just like the Soft Drink bill," I should note, with all respect for the good intentions of the supporters, that there are significant differences between the two industries and the circumstances which

prompted Congressional consideration of the legislation.

Specifically:

- The structure of the two industries is different.
- The economic impact of the two industries' local facilities upon the various communities in which they are located is quite different.
- The Constitutional authority and precedent for regulating the two industries are different.
- The legal environment in which the malt beverage industry is operating today is much different than the legal environment which confronted the soft drink industry in 1980.
- Congress did not intend for the Soft Drink legislation to be utilized as a precedent for any subsequent legislation.

Perhaps a more thorough discussion of these five points will help emphasize the differences.

Different Structures

Soft drink products now are mixed, bottled and distributed by over 2,000 production facilities throughout the country. More importantly, a large majority of soft drink production facilities are owned and operated as independent small businesses. In the malt beverage industry, the final product is produced in a relatively few, large industrial facilities, all of which are owned and operated by the parent companies of the various brands of malt beverage.

Different Economic Impact

Each local soft drink bottling facility requires sufficient capital, management and manpower to actually create and operate a production facility as well as sufficient resources to distribute soft drinks once they are manufactured. The local distributors of malt beverages, on the other hand, require only those capital, management and manpower resources necessary to store and distribute the product -- essentially no different than wholesalers of many products.

Different Constitutional Authority for Regulation

The Twenty-first Amendment to the United States Constitution specifically delegates the power to control alcoholic beverages to

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the individual states: "Section 2. The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited." Thus, the malt beverage industry is the subject of extensive state and local control which is not applicable to the soft drink industry. Each state subjects the malt beverage industry to a three-tier regulatory system (producers of malt beverages are prohibited from owning either a distributing or a retail facility). This effectively eliminates vertical competition within the industry. Vertical competition is not prohibited in the soft drink industry.

Interestingly enough, twenty-seven states presently require the type of market allocation which is sought by the malt beverage legislation. Twenty-two states are neutral on this subject, and thus permit exclusive territories if desired by the brewers and their wholesalers. Only one state, Indiana, specifically prohibits this practice.

Different Legal Environments

In 1971, the Federal Trade Commission began proceedings against several soft drink companies, alleging that the territorial provisions incorporated in licensing agreements between these companies and their bottlers constituted an unfair method of competition. Extensive hearings on this complaint were held before an Administrative Law Judge who, after making detailed findings of facts concerning the level of competition and the industry itself, found that the territorial provisions were not an undue burden on competition and therefore, were not illegal.

Depsite these findings by the Administrative Law Judge, counsel for the FTC appealed the Judge's decision to the full Federal Trade Commission, and after several oral arguments on the matter, the Commission, on a 2-1 vote, ruled that the territorial provision constituted an unreasonable restraint of trade. This decision was made in 1978, almost seven years to the day from the

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initiation of the proceedings against the industry. An appeal of the FTC decision was taken to the U.S. Court of Appeals for the District of Columbia.

Mr. Chairman, this was the legal setting when I introduced the Soft Drink bill on March 8, 1979. Of course, I cannot speak for other Members of the Senate at that time, however, let me emphasize what led me to introduce this legislation. An agency of the Federal government for eight years had been vigorously pursuing and was continuing to pursue a policy which was designed to change the way the Soft Drink industry had operated for three-quarters of a century. Moreover, the change in the status quo, which was to be brought about by the Federal agency, would lead to widespread disruption and dislocation within that industry and within the towns and cities in which the industry's plants were located. The findings of the Administrative Law Judge emphasized that this dislocation would result from the elimination of the territorial provisions. He found that this approach

> ". . .would adversely affect competition because it would lead to the business failure of many small and some large bottlers as well as to the accelerated growth of large bottlers."

* * *

> "The contributions to the economies of the area in which small bottlers and their employees now earn their living would certainly diminish substantially and would disappear completely if a bottler were forced out of business." [See Coca-Cola et al. 91 FTC 517 at 587 (1978).]

The record is clear that it was in response to the FTC decision, which would have admittedly disrupted the status quo and resulted in plant closings and unemployment, that we proceeded with the Soft Drink bill. In fact, on the first day of hearings on S. 598, I stated in my opening statement:

> "This legislation is in response to a Federal Trade Commission instituted proceeding to bar as unlawful territorial franchise agreements with bottlers by soft drink syrup companies." [See Hearings Before the Senate Subcommittee on Antitrust, Monopoly and Business Rights on S. 598, June 4, 1979, p. 1.]

In 1980, Congress recognized that the active policy of the FTC toward the Soft Drink industry would have resulted in a massive

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disruption of that industry and its employees and would have had a negative impact upon the hundreds of cities and towns in which the industry's plants were located. These unique legal characteristics and conditions which confronted the Soft Drink industry in 1980 do not exist today insofar as the Malt Beverage industry is concerned.

There is no long-standing nor on-going effort by a Federal agency to destroy the status quo within the malt beverage industry. Indeed, as far as I know, there has been no successful private anti-trust suit or proceeding of any kind against the malt beverage industry since before the GTE-Sylvania decision in 1977.

No Precedent Intended in Soft Drink Bill

The legislative history of the Soft Drink Interbrand Competition Act is replete with the stated acknowledgment that the bill was not designed to set a precedent for other industries and that its provisions were based on the unique characteristics and history of the Soft Drink industry. The House Judiciary Committee Report devoted two pages to a description of the unique qualities of the Soft Drink industry [See House Report 96-1118]. In addition, the Senate Committee Report noted some of the unique characteristics of the Soft Drink industry which made this legislation particularly compelling:

> "In June, 1979, this Committee heard testimony concerning the structure and dynamics of the Soft Drink industry. According to the testimony, there are 1,724 soft drink bottling companies competing in the United States in 1978. Of the 2,048 bottling plants in the United States, 1,412 had fewer than 50 employees. Many of these plants are family owned; many of them hire a significant number of employees in the small communities in which they are located. [See Senate Report 96-645.]

Although I hesitate to quote myself again, perhaps my remarks at the beginning of the floor debate will shed some light on the intention of the author of this legislation and, to some extent, upon the intention of the Senate when passing it:

> "I would like to emphasize, Mr. President, that although there has been a concern expressed about the precedent we have been setting here by passing the Soft Drink Interbrand Competition Act, it seems to me that the precedent has already been set and has been established. We are not

> suggesting that something new and novel be foisted on the consuming public or the Soft Drink industry, but we are suggesting that something good and sound, both from a business practice and a consuming standpoint for seventy-five years, should not be summarily removed from the books by an act of the Federal Trade Commission."
> [See Congressional Record, May 13, 1980, p. 10958.]

In summary, Mr. Chairman, whatever pro or con arguments may exist on the merits of the Malt Beverage bill, I believe that the argument that it is "just like" the Soft Drink Act is one which cannot withstand a review of the legal and legislative background of the Soft Drink legislation.

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Senator METZENBAUM. Ms. Priscilla Budeiri and Dr. Richard Lipsky, would you both care to come to the table at the same time?

Ms. Budeiri and Dr. Lipsky, I want to say to you that I was not originally scheduled to chair this hearing. The chairman has to be on the floor. As a consequence, I made some other commitments, so I am going to ask if you could confine your remarks to 7 minutes.

We gave a little leeway to a former Senator, but I would like to be a little stricter with you, if you could hold yourself down to that. It is nice to have you with us.

STATEMENT OF A PANEL CONSISTING OF: PRISCILLA BUDEIRI, STAFF ATTORNEY, PUBLIC CITIZEN'S CONGRESS WATCH, WASHINGTON, DC, ON BEHALF OF PUBLIC CITIZEN AND THE CONSUMERS UNION; AND RICHARD LIPSKY, PUBLIC POLICY CONSULTANT, EMPIRE STATE BEER DISTRIBUTORS ASSOCIATION, INC., BELLEROSE, NY

Ms. BUDEIRI. Thank you very much, Mr. Chairman. Good afternoon. My name is Priscilla Budeiri and I am an attorney at Public Citizen's Congress Watch. It is once again my pleasure to appear before this committee to present the consumer view of an antitrust bill.

I am speaking today in opposition to the beer bill on behalf of the consumer members of Public Citizen, as well as the 3½ million readers of Consumer Reports and the other supporters of Consumers Union.

Although it is very hard to resist speaking in technical, legal and economic terminology about an antitrust bill, I am sure this committee has heard all the arguments as to why the beer bill is bad law and bad economics by the many Federal agencies and public-interest bodies that have already testified.

These groups include the Department of Justice, the Federal Trade Commission, the National Association of Attorneys General, the American Bar Association, and the Consumer Federation of America.

Senator METZENBAUM. How do you account for the fact that with all those witnesses testifying against it, this bill has got so many cosponsors?

Ms. BUDEIRI. I wish I knew, Mr. Chairman. Certainly, it would not be my choice if I were on the other side of this table.

My message today is rather simple, and that is that the significance of the beer bill is not lost on consumers. They are extremely concerned about the bill. Consumers know that the beer bill is a perfect example of special-interest legislation.

It is an attempt by the beer industry to get a break from the antitrust laws, and if the beer industry succeeds, consumers will literally pay the price. They will more than likely be faced with higher beer prices and deteriorating service.

Consumers have concluded that there is absolutely no justification for this bill either in law—the current standard used to judge exclusive territories in the beer industry has been around since 1918 and is applied to just about every other industry in this country—nor is there any justification for this bill in economics.

There is nothing about the structure of the beer industry that justifies special antitrust treatment. As a matter of fact, it is quite to the contrary. The beer industry is a highly concentrated industry and the brewers spend large amounts of money every year trying to convince us to buy their particular brand of beer. Therefore, there is extremely strong brand loyalty among beer drinkers.

This, plus the very high concentration in the industry, means that consumers are basically captive to the beer industry. The beer industry can therefore increase the price of beer and as long as it is not an incredibly large price increase, they will probably get the prices that they charge.

Giving the beer industry a break from the antitrust laws, therefore, would be unfair to consumers and all the law-abiding firms in our economy.

Positive action on the beer bill would also be unwise. As the chairman stated in his opening comments, consumers agree with you that favorable treatment of the beer industry will encourage other industries to seek similar relief from competition. Neither Congress nor consumers need an onslaught of special interests trying to get their own exemption from the antitrust laws.

What we do need is a clear and unequivocal no to the beer industry and the other special interests that are poised to seek their own exemption from the antitrust laws.

Thank you for considering the views of consumers on this matter.

[The statement follows:]

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STATEMENT OF

PRISCILLA BUDEIRI

STAFF ATTORNEY

PUBLIC CITIZEN'S CONGRESS WATCH

and

MARK SILBERGELD

DIRECTOR, WASHINGTON OFFICE

CONSUMERS UNION

Mr. Chairman and Members of the Committee:

I am Priscilla Budeiri, a staff attorney with Public Citizen's Congress Watch. Public Citizen was founded in 1971 to represent the interests of the consuming public before the three branches of American government. It is supported by 80,000 members throughout the United States. Congress Watch is the section of Public Citizen that brings the interests and concerns of consumers to the attention of our lawmakers.

I am also presenting this statement on behalf of Consumers Union, the publisher of Consumer Reports Magazine. Consumers Union is a nonprofit membership organization chartered in 1936 to provide information, education, and counsel about consumer goods and services and the management of the family income. Consumers Union's income is derived solely from the sale of Consumer Reports, which has a circulation of approximately 3.5 million, its other publications, and films.

Public Citizen and Consumers Union strongly oppose the "Malt Beverage Interbrand Competition Act," S. 412, also called the beer bill, because it is the epitomy of special interest legislation: it is designed to bring relief to one sector of our economy, the beer industry, at the expense of the general public. The beer bill removes the beer industry from the regular application of the antitrust laws for no principled legal, economic, or policy reason. By establishing a different standard

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to judge vertical restrictions in the beer industry than is applied to most other sectors of our economy, the beer bill threatens to decrease consumer welfare. The beer bill will harm consumers by (1) raising the price of beer and (2) encouraging other industries to seek unjustified exceptions to the antitrust laws. Public Citizen and Consumers Union, therefore, join the ranks of those who have already appeared before you to express their opposition to the beer bill. These groups include the United States Department of Justice, the Federal Trade Commission, the National Association of Attorneys General, the American Bar Association, and the Consumer Federation of America.

This testimony reviews the change the beer bill makes in current law, describes the effect the change will have, and explains why there is no sound legal, economic, or policy justification for the bill.

The New Antitrust Standard In The Beer Bill:

The beer bill purports to "clarify the circumstances under which territorial provisions in licenses to distribute and sell trademarked malt beverage products are lawful under the antitrust laws."[1] Section 2 of the bill provides that the antitrust laws shall not apply to an exclusive distributorship or a territorial monopoly held by a beer wholesaler if the product being distributed is in "substantial and effective competition" with other malt beverage products in a defined geographic area.

The bill changes the way the antitrust laws are applied to territorial monopolies in the beer industry. Currently, beer distributors' territorial monopolies are evaluated in the same manner as non-price vertical restraints in most other industries. The 1977 Supreme Court case entitled Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977), governs that analysis. It overruled an earlier case which struck down an exclusive territory as per se illegal and held that the "rule of reason" test should be applied to those arrangements in the future. The

"rule of reason" standard requires that the harms and any benefits of a vertical restriction be identified and weighed. If the harms predominate, the vertical arrangement will be prohibited.

The Court suggested that non-price vertical restraints, while restricting intrabrand competition, or competition within one brand of a commodity, may also encourage interbrand competition, or competition among brands of a given commodity. Certain manufacturers may want to encourage their retailers to engage in more aggressive interbrand competition because of the so-called "free rider' effect, the Court reasoned.

The "free rider" problem tends to occur in industries where efficient marketing is characterized by product promotion or point-of-purchase services.[2] Retailers in these industries may try to minimize the resources they allocate to advertising or service and repair facilities by "free riding" off their competitors in the market. The less a firm spends on these aspects of marketing, the more it can reduce the price it charges the consumer. The consumer, on the other hand, may purchase the product at the "free rider's" lower price and take advantage of the advertising, service, and repair networks offered by another firm in the market.[3] If a firm is guaranteed to be the sole retailer of a product in a geographic area, however, it will have more incentive to make the investment required to engage in effective marketing. See 433 U.S. at 54-55.[4]

The Court did not, however, ignore the importance of intrabrand competition and everyday experience attests to its usefulness to consumers. For example, when a person decides to buy a television, he will take advantage of interbrand competition and compare, perhaps, General Electric, Panasonic, and Zenith. Once the consumer has decided which brand contains the best combination of features, he will engage in intrabrand competition by shopping around for the store that sells the brand

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he wants at the least expensive price. The Court in the GTE case, therefore, made the legal standard applicable to non-price vertical restraints very flexible to account for and balance both interbrand and intrabrand competition.

The beer bill, however, totally ignores intrabrand competition and relies solely on an undefined amount of interbrand competition in an unspecified market. This change will only have a negative effect on consumer welfare.

The Beer Bill Will Have Only Harmful Effects On Consumers:

The new standard contained in the beer bill will adversely affect consumers from a legal, economic, and policy point of view.

The Beer Bill Is Not Good Law:

The alteration of the standard used to judge territorial monopolies in the beer industry will have primarily three adverse legal effects. First, although the purpose of the beer bill purports to be clarification, it really does just the opposite. It replaces a standard which has been applied by the courts since 1918, with an undefined test.[5] The bill neither defines what constitutes "substantial and effective competition" nor explains which market it applies to or which party has the burden of proof. This lack of clarity will engender litigation and cause the expenditure of resources associated with litigation.

Second, while the new test is not defined in the bill, it will undoubtedly permit vertical arrangements which the current rule of reason standard would disallow.[6] The beer bill, therefore, will reduce the protection the antitrust laws afford consumers.

Third, passage of the beer bill will weaken the already beleagured antitrust laws. Strong, universally-applicable antitrust laws are a vital component of our free market economy. When they are usurped in any one industry for no principled reason, other industries are encouraged to seek similar relief

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from the competitive forces that underlie our capitalistic system. This bill, in fact, is itself an example of this phenomenon.[7] Instead of encouraging an onslaught of requests for relief from competition by acting favorably on this bill, Congress should strengthen the antitrust laws by reducing, whenever possible, the number of industries that are exempt from their strictures.

The Beer Bill Is Not Good Economics:

The economic effects of the beer bill will be particularly harsh due to the structure of the beer industry. Beer brewers operate in an extremely concentrated market: the four largest brewers account for 79.9% increase of the national market.[8] The two largest, Anheuser-Busch and Miller, constitute 57.1% of the national market.[9] This concentration is aggravated at the distribution level because distributors often market more than one brand of beer. An exemption from the antitrust laws in these circumstances will only increase opportunities for collusion.[10]

The Beer Bill Is Bad Policy:

The antitrust laws are designed to enable our free market economy to work effectively and efficiently. When it does, competitive prices and service options are offered to consumers. The exemption of the beer industry from general antitrust scrutiny will upset the optimum level of price and service options offered to consumers. If the beer bill is passed, therefore, beer prices can be expected to rise and distributors' service will tend to slacken off due to the removal of the discipline competition brings.

A rise in beer prices if this bill were to become law is more than just an application of theory. Price data already presented to this Committee indicate that the existence of territorial monopolies among beer wholesalers in two states resulted in higher beer prices for consumers. When Indiana abolished territorial monopolies among beer distributors, beer

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prices fell between 8% and 20%. Data collected after the two major brewers in New York, Anheuser-Busch and Miller, began requiring territorial monopolies for their distributors indicate a rise in price by as much as 31%, or 21% more than the rise in soda prices during the same period.

Conclusion

Public Citizen and Consumers Union strongly oppose the beer bill because it will weaken the antitrust laws and eliminate competition in an already highly concentrated market. Consumers will also be harmed by the rise in prices the bill can be expected to cause. We, therefore, urge this Committee to reject the beer bill as it did in the 97th and 98th Congresses.

NOTES

1. The arrangements covered by the beer bill include exclusive distributorships and territorial monopolies. These vertical arrangements are made between a brewer and a beer wholesaler and generally provide that the wholesaler will be the only business able to market a given brand of beer in a defined geographic area. A consumer in that area who wants to buy the beer, therefore, will have to buy it from the assigned wholesaler at the price the wholesaler sets.

2. These industries include major household appliances and automobiles.

3. See, in general, Lester G. Telser, "Why Should Manufacturers Want Fair Trade?" Journal of Law and Economics, vol. 3 (October 1960).

4. Wholesale malt beverage distributors operating territorial monopolies are currently judged by the "rule of reason" standard despite the fact that they cannot claim any of these special "free rider" circumstances. Beer does not break down, so its wholesalers do not need to build service and repair networks. Furthermore, most beer promotion and advertising is done on the national level by the brewer.

5. Furthermore, five recent cases show that the courts are fully aware that the GTE case governs the legality of territorial monopolies in the beer industry. See Mendelovitz v. Adolph Coors Co., 693 F.2d 570 (5th Cir. 1982), Maykuth v. Adolph Coors Co., 690 F.2d 689 (9th Cir. 1982), Del Rio Distributing Inc. v. Adolph Coors Co., 589 F.2d 176 (5th Cir.), cert. denied, 444 U.S. 840 (1979), Lamp Liquors, Inc. v. Adolph Coors Co., 563 F.2d 425 (10th Cir. 1977), and Adolph Coors Co. v. A & S Wholesalers, Inc., 561 F.2d 807 (10th Cir. 1977). It is clear, therefore,

that supporters of the bill cannot claim, as the soft drink industry did during consideration of the Soft Drink Interbrand Competition Act, that there is confusion concerning which legal standard applies to its distributors' territorial monopolies. See also statement of Charles F. Rule, Acting Assistant Attorney General, Antitrust Division, presented to this Committee on May 14, 1985, n. 5.

6. The new standard is not stricter than the rule of reason test because it ignores intrabrand competition. If it were meant simply to recodify the current rule of reason test, it would be superfluous. Therefore, it must be a less lenient standard.

7. The beer bill is modeled after the Soft Drink Interbrand Competition Act, 15 U.S.C. §§ 3501-03 (1980).

8. Modern Brewery Age Blue Book at 171 (1985).

9. Id.

10. The ease of engaging in collusion and maintaining cohesion among colluders increases as market concentration increases.

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Senator METZENBAUM. Thank you very much, and let me say that I do not think we have received very much mail from consumers and I am sort of curious as to why there has not been more of a public response from consumers, who would complain if they were apprised of the fact that beer prices would go up if this bill passes.

Ms. BUDEIRI. I believe perhaps one reason is that consumers thought that since this bill has been rejected basically two other times in the 97th and 98th Congresses that there is an impression that this bill is dead.

I would certainly like to think it is, but my closeness to Congress tells me that that is not the case. So perhaps consumers are being lulled into thinking that this issue, since it is so meritless, is dead and should be dead.

Senator METZENBAUM. I would think that the grocers of this country would all be having signs indicating what is going to happen if this bill passes and that there might be some public response.

But it is my opinion that, since this bill has been introduced, I doubt very much that I have received 50 pieces of mail in opposition to it. And I would say to you as spokesperson for an organization that has 3½ million readers, I think, of your magazine, I think if there is not some great consumer outpouring of opposition, it is going to be very difficult to keep this legislation from being enacted into law, notwithstanding my own strong feelings against it. But I do not see too many allies out there who are prepared to make the fight.

Ms. BUDEIRI. Public Citizen will certainly continue its strong opposition to this bill, and I am sure my colleagues at Consumer Reports, Consumers Union, and Consumer Federation of America will do the same thing.

Senator METZENBAUM. Thank you.

Dr. Lipsky.

Dr. LIPSKY. Thank you, Mr. Chairman.

Senator METZENBAUM. Dr. Lipsky, would you hold it for a minute? I think Senator Denton came in; I did not see him arrive.

Do you want to make a statement, Senator Denton?

Senator DENTON. No, thank you, Senator Metzenbaum. I think I will listen in for a while.

Senator METZENBAUM. Fine.

TESTIMONY OF RICHARD LIPSKY

Dr. LIPSKY. Thank you, Mr. Chairman. I just want to take a small exception to something Priscilla Budeiri did say when she lumped the beer industry as a monolith. I represent the Empire State Beer Distributors in New York and we are secondary distributors, not primary wholesalers.

In New York, there is a four-tier distribution system, and what I am about to say should give some indication to the committee, and hopefully to the entire Congress, that making blanket national law as far as the distribution of malt beverages can have a deleterious impact on localities that do distribute beer in a slightly unorthodox fashion.

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I am here to express the Empire State's total opposition to the Malt Beverage Interbrand Competition Act. My testimony emerges out of a knowledge of a particular marketplace, which is the New York marketplace. I do not pretend to speak authoritatively for the entire country, but I think that my remarks could be instructive as to the potentially dangerous impact of the passage of the Malt Beverage Interbrand Competition Act.

Empire State represents the secondary distributors of beer and soda in New York State. These businesses, popularly known as beverage centers, are part of a unique four-tier distribution system for malt beverages in the State.

In New York, we have the franchise distributors who hold a C license and are appointed by the brewery to distribute their products in what has been called an area of primary responsibility.

Basically, what we do, and we represent 500 different beverage centers throughout the State of New York—we redistribute products throughout the State. We buy from various primary wholesalers and sell in multibrand fashion to food retailers in the State.

One of the things I want to emphasize, since I know my time is limited, is I would like to take issue very strongly with the statement made by Senator DeConcini, who unfortunately is not here at the present time.

Senator DeConcini mentioned that those people who were opposed to the Malt Beverage Interbrand Competition Act represented big business. In the State of New York, those people who are opposed to the Malt Interbrand Competition Act represent the small mom and pop businesses throughout the State.

Empire State members service all of the bodegas—which are the Spanish groceries—all of the delis, all of the smaller stores in the inner-city area that have been abandoned by the primary wholesalers.

The major argument made by supporters of the Malt Interbrand Competition Act is that the Safeways and the Krogers are going to benefit somehow from lack of passage of the Malt Interbrand Competition Act.

In reality, the people who are going to benefit are the primary wholesalers in the State of New York, and what they will be doing in this case is to continue to exercise their hammerhold over distribution.

At the present time, there are eight distributors in the New York City metropolitan area who basically control 95 percent of all the beer sold in that particular area. Now, we are talking about quite a few million people in this particular area.

What we see happening continually is concentration not only at the brewery level, but also at the distribution level, where your Budweiser distributor also is disbributing Heineken and Molson and Schaefer and Stroh's. It is the kind of situation which makes it almost impossible to buy competitively from other sources.

Senator METZENBAUM. Can a Brooklyn wholesaler or distributor member of your organization sell his product in Manhattan?

Dr. LIPSKY. Yes, yes. Our people are secondary distributors. We can buy from a Brooklyn primary wholesaler who has a contract with a brewery. When we buy from that wholesaler, we can sell anywhere in the State of New York. We also can buy from a pri-

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mary wholesaler in Oneonta, NY, upstate New York, and sell it in New York City, in the practice that is pejoratively labeled as transshipping, which turns out to be that age-old anti-American practice of buying cheapest and selling cheapest in quantity discount prices.

Senator METZENBAUM. If this bill passes, you would not be able to do that?

Dr. LIPSKY. We would be effectively put out of business, Senator. What would happen would be that the practice of transshipping would be effectively eliminated.

Let me emphasize that the major study that was done by the Rockefeller Institute of Government on the distribution of malt beverages in the State of New York, which was done after the passage of the State's mandatory deposit law—what the Rockefeller Institute of Government found was that our beverage centers are offering the cheapest prices to the consumer—9 percent cheaper than the largest chain stores.

I think what is indicative here is the fact that the reason we can offer such bargain prices to the consumer is that we can buy competitively.

Senator METZENBAUM. Nine percent?

Dr. LIPSKY. Nine percent cheaper than the largest chain stores. Basically, if we could take a tour of some of my members' facilities, you will see very small mom and pop operations, ranging from $500,000 a year to about $5 million a year in business. We are not large, multinational corporations or anything of that nature.

What the Rockefeller Institute of Government also emphasizes and what should be emphasized here, Senator, is the fact that the beverage center, as the third tier in the distribution system, is the link to the small shopkeeper.

The small shopkeeper is often forced to buy for cash, often forced to buy on holidays when his supply runs out, often forced to buy on a Saturday when the primary wholesaler is not available.

Our members, open as they are almost around the clock 7 days a week, offer that inner-city service to the small shopkeepers. Again, with the passage of this bill, that service and our businesses would be effectively eliminated.

Senator METZENBAUM. Thank you very much. We appreciate your testimony, Ms. Budeiri and Dr. Lipsky. I do not know whether Senator Denton has any questions.

Senator DENTON. No. I think you expressed my thoughts, Senator Metzenbaum, when you suggested that we needed to review this bill in light of its effects on the consumer.

I am concerned that the bill runs contra to my concept of free enterprise. Therefore, I am leaning against the bill, and you presented me new information, Senator Metzenbaum, when you concluded that there is an overwhelming chance that it will be passed on the floor. Did you mean on the floor or in the committee?

Senator METZENBAUM. Well, I would say that in committee, it looks pretty optimistic, and I would say that, barring some considerable opportunity to explain to our colleagues what is wrong with this bill, which I am prepared to do even if it takes a little time to do it, I am afraid that there may be the votes out there to pass it.

But I believe that it is anticonsumer and I believe it to be antifree enterprise, and I do not believe it is in the best interests of

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this country. I think that we have got 111 different subjects that I think are entitled to more priority consideration than exempting the beer industry from the antitrust laws.

So I hope that the leadership does not see fit to bring it up, particularly since it is such a weighty matter that will require a lot of discussion.

Senator DENTON. We might find ourselves on the same side, and not only for free enterprise reasons and consumer reasons, but perhaps States' rights.

Senator METZENBAUM. Well, I think that would be very good to have a northern conservative like me and a southern liberal like you on the same side. [Laughter.]

With that, I want to thank the witnesses for appearing here today. I know that they particularly wanted to be heard, and I want to express my appreciation to the chairman for seeing fit to set this second hearing today.

That concludes the hearing.

[Whereupon, at 4:02 p. m., the committee was adjourned.]

[Prepared statement follows:]

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PREPARED STATEMENT OF DR. RICHARD LIPSKY

My name is Dr. Richard Lipsky. I teach Political Science at Queens College in New York. I am also a policy consultant to the Empire State Beer Distributors Association. I am here today to express the total opposition of Empire State to the Malt Interbrand Competition Act, a piece of legislation that would leave the old robber barons chuckling and rubbing their hands in gleeful anticipation.

Empire's opposition and my testimony emerge out of a knowledge of the system of distribution for malt beverages in New York State, and does not purport to speak authoritively for the entire country. New York State does, however, represent one of the largest markets in the country, and my testimony should hopefully shed some light on the possible nationwide dangers of the creation of territorial monopolies for franchised beer wholesalers.

Malt Brand Distribution in New York State:

Empire State Beer Distributors Association represents the secondary distributors of beer and soda in New York State. These businesses, popularly known as beverage centers, are part of a unique four tier system of distribution for malt beverages in the State. In New York we have the franchised distributor, who holds a "C" license, and is appointed by the brewery to distribute his product in what has been called an area of primary responsibility. Since the promulgation of equity agreements between the brewer and his wholesaler, these areas of primary responsibility have been contractually transmuted into territorial monopolies.

The members of Empire exist at a level just below that of the franchised wholesaler. Holding the same "C" license as the franchised wholesalers, Empire members buy from

primary wholesalers in large, often trailor-load quantities, for wholesale re-distribution and/or retail sales. There are over 500 beverage centers in the State of New York. Our centers, buying competitively from many different sources, have traditionally offered consumers the best competitive prices, while creating an environment where all primary wholesalers have to be at their most competitive. This practice, perjoratively labelled by the franchised wholesalers as "transshipping", turns out to be the age-old, anti-American practice of searching for the cheapest source of supply and the re-selling of the product at a good discount.

In New York City alone, this secondary distribution process accounts for up to 55% of all the beer sold. In the Bronx, New York, there are 30 discount beverage operations doing over $50 million a year in sales. The beverage centers, saturated primarily in low-income neighborhoods, provide a vital service for thousands of "Mom and Pop" stores who have been abandoned by the primary wholesalers. In acting almost like a convenience store, these small retail stores do the bulk of their high-volume beer business on weekends and holidays. This fact, compiled with brand proliferation, has made it impossible for this type of store to compete with the supermarkets and survive in an environment where they must purchase, usually on a COD basis, from as many as a dozen different beer and soda vendors. The beverage centers, open for longer hours and on weekends, deliver mixed product lines on Saturdays, Sundays and holidays. In addition, the beverage center is available for the small grocer on a cash and carry basis as he either runs out of goods or gets the cash to purchase more product. In the low-income areas of the State, particularly, the multi-brand beverage distributor is an economic necessity.

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Equity Contracts and Transshipping:

We are here today to discuss the creation of legislated monopolies. It must be pointed out, however, that the promulgation of equity contracts by many of the largest breweries has created a de-facto monopoly situation for the franchised wholesalers. These equity contracts have already given primary wholesalers extra ordinary control over distribution. These contracts which threaten wholesalers with the termination of their franchise if they are caught selling outside of a particular assigned territory, have had a chilling effect on the ability to purchase product inexpensively. The transshipping that has survived has done so for the following reasons:

1. Certain wholesalers have territories that are so unprofitable that the potential risk of fighting an Anheuser-Busch is not so great, and

2. The large breweries have left a small transshipping window open to counteract any potential anti-trust action against the equity contracts.

Empire State, along with the Attorney General of the State of New York, has been a prime mover in sponsoring legislation in the New York legislation that would make these equity contracts illegal. At the present time, however, the existence of contractual monopolies has already illustrated how concentration of the beer industry at the level of wholesale distribution has a deleterious impact on the public interest.

Equity Contracts and Price:

Since the establishment of equity contracts four years ago, beer prices in New York and New Jersey have rapidly escalated. Professor Jordan, of Seton Hall, has done an extensive analysis over a three year period that charts the remarkable similarity of price changes by both Miller

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and Budweiser. A similarity in timing, as well as magnitude. In New York, evidence is strong that de-facto monopolies led to price gouging and windfall profit-taking. With the inception of the State's bottle-deposit law, premium beer prices rose 18%. Arguments persist as to whether these increases can be attributed largely to the brewer or the local wholesaler. For the purposes of our present discussion, the distinction is irrelevant. Because of anticompetitive arrangements between brewers and their wholesalers, the consumer was socked in the teeth. Presold by clever advertising campaigns, the consumer sticks to "his" brand and the impact of price on competition is diminished. When the two top brands, comprising as they do over 75% of New York City's market, capriciously raise prices the whole industry follows along in the "me, too" profit-taking.

The national brands are not competing on price in New York. The State commissioned the Rockefeller Institute of Government to study, among other things, the impact of the bottle deposit law on beverage prices. The RIG report clearly pointed out that in upstate New York, Miller and Budweiser were unable to arbitrarily raise prices to the same high levels as downstate because of the strength of Genesee, a strong local brewery. The theoretical concept of interbrand competition is valid. Unfortunately, in too many large markets, brewer and wholesaler concentration effectively restrains price competition.

In the seven downstate counties of New York, just two Miller and six Budweiser distributors service a population of over eleven million people. In addition, these eight wholesalers also control distribution of most of the other beers in the largest beer market in the country. Heineken, Becks, Molson, Piels, Schlitz, Old English, Colt 45 - the

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list is almost endless. These royal eight now control over 85% of the entire downstate market.

Concentration in the beer industry is further demonstrated by the highly visible campaign to market the so-called popular price brands. Advertisements for Meister Brau, Milwaukee's Best and Busch beer give the popular impression that there is price competition among beer brands. In reality, however, what we are really seeing is the attempt of the strongest breweries to gain strength in a particular segment of the market at the expense of rapidly weakening national breweries and beleaguered local breweries. The elimination of the smaller brands in the popular price segment will eventually lead to the further aggrandizement of the big nationals and price escalation and profit-taking. This A & P tactic in the late thirties was a prime motivation behind the passage of the Robinson-Patman Act.

Transshipping and Price:

The Rockefeller report makes one very important observation concerning the inter-related issues of transshipping, competition and price. The report observes:

> "Transshipment is a major form of competition...Any reduction in industry competition may not only harm consumers in general, but would also likely reduce the effectiveness of the Returnable Beverage Container Law..."

The findings on transshipping were so clear that the Commission charged with making recommendations to the legislative on the deposit law voted 8-1 to make no alterations in the law that would harm the competitive practice of transshipping.

The RIG report, along with the market basket survey done by the State Office of Consumer Protection, clearly indicated that Empire's discount beverage centers - in

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spite of all the pass-along price increases - were able to sell beer cheaper than any other retail outlet (9% cheaper than the largest chain stores). Since beverage centers are the major conducts for transshipping in the State, the lesson is obvious. In a climate where one or two brands dominate, the only competition is between wholesalers of the same brand. Ironically, in a study done by Long Island University, and commissioned by the New York State Beer Wholesalers, it was also found that beverage centers offered the best beer prices. I say ironically, because it is this same organization, along with its national parent, that wants to eliminate the beverage centers competitive role through the passage of the Malt Interbrand Competition Act.

From the standpoint of the consumer, from the standpoint of a healthy competitive marketplace public policy, the Malt Interbrand Competition Act makes no sense. In fact, the protection of the public interest would best be served if the United States Congress body would consider restraining the monopolistic practices of billion dollar breweries by passing legislation that would make illegal the restrictive covenants called equity contracts.

A liability would be that some consumers would be inconvenienced. Although many consumers spend the returns in the store anyway, some do not, and most consumers might want to retain the cash at one time or another. It might be that competitive pressures would lead retailers to strike a balance between store convenience and consumer convenience, even perhaps increasing the face value of the chit from 5 cents to a higher level.

Another liability would be that "street people" who do not spend rebated deposits in the stores would be disadvantaged. However, a secondary market for chits, in which individuals would receive cash for part of the face value of the chit, could be expected to develop.

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There are obvious benefits and problems of the retailer's proposal. It is an interesting idea, however, and deserves serious consideration by the Commission.

Establishment of Exclusive Territories

It has been maintained that transshippment, particularly around New York City, creates serious problems for beer wholesalers in a deposit environment. There is a danger of overredemption, where distributors are forced to "eat" the returns of other distributors who have collected the deposits.

However, overredemption at the distributor level is not a serious problem in the New York City area. Return rates in the New York City area are around 80 percent for beer.

There is another problem, however. The suspicion of transshipping, and the resistance to redeeming other distributors' containers, arguably leads distributors to discourage returns. Such discouragement is not legal, and the Department of Environmental Conservation could act against it. However, the DEC has not been able to sustain a credible enforcement program regarding beer distribution in New York City (DEC administration is discussed later in this Chapter).

Up to now, it appears that informal arrangements for dealing with transshipped containers--partly prompted by the early discouragement of returns--have been worked out, with transshippers either back-hauling containers or contracting with New York City third party systems for collection and disposal. These arrangements were reported in numerous interviews in the New York City area. Also, the upstate return rate for beer is over 90 percent, and much transshippment reportedly originates from upstate distributors. Such high return rates imply that upstate wholesalers are recovering many of the transshipped containers in one way or another.

However, the most substantial concern regarding transshippment and the future of the RBCL is that it arguably would prevent distributors from cooperating in the large third party redemption systems which appear to be the best way to improve the efficiency of redemption in the

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downstate area. Distributors would resist losing any further control over their redemption process.

Yet, the danger of eliminating transshippments must also be recognized, particularly in view of the large beer price increases in the downstate area around September, 1983. Transshippment is a major form of competition. To the extent that the law has been implemented effectively, it is because of the relative competitiveness of the soft drink and beer industries, and their needs to maintain good buyer-seller relations and prices that are competitive in the long run. Any proposal involving significant reduction in industry competition may not only harm consumers in general, but also would likely reduce the effectiveness of the RBCL and perhaps even third party operations.

BREWER INITIATION OF DEPOSIT

Another proposal would be to have the brewer initiate the deposits for non-refillable beer containers. Currently brewers initiate the deposits for refillables on the grounds that they must recover the bottle for refilling. Generally, wholesalers initiate the deposit for non-refillables, collecting and processing the containers and also retaining any deposits for non-returned containers. Those who advocate general brewer initiation of the deposit maintain that currently wholesalers have a monetary interest in discouraging redemptions--their pool of retained deposits increases as fewer containers are returned. Brewer initiation would mean that wholesalers could neither gain nor lose from the flow of deposits because every deposit that wholesalers collect from a retailer would be balanced by a deposit paid to the brewer.

Also, wholesalers now are potentially in the position of over-redeeming containers because of transshipping, migration of containers, and other factors. For that reason, wholesalers might be unwilling to participate in third party redemption systems, in which they arguably would lose some control over the redemption process. Brewer initiation would preclude the possibility of overredemption (Anheuser-Busch, for example, could not overredeem its own containers), removing one barrier to the development of third party systems.

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Hail to the Chief

. . . of Fort Apache

Jimmy Mercado, in many ways, epitomises the importance of Empire State and the role its members play in their communities. More significantly, however, his story tells us something about America as a place where one can still pull himself up by the bootstraps if one has—in Jim's words—"a little guts, brains and determination."

By Richard Lipsky

It's an unusual place, as places go. A curious mixture of the good, the bad and the different. One area is called Fort Apache, while not too far down the street, the "Boss" amasses his men in pin stripes to play "Billy Ball." Paul Newman made a movie there, and our last four Presidents toured the area.

The hard realities of life come forward quickly in the South Bronx. Low income and unemployment are just two of the factors which contribute to a lifestyle where the mundane is luxury. And yet, the South Bronx can be rewarding to a conscientious businessman.

Just around the corner of Intervale Avenue and 163rd Street is Dee Jay Beverage. James Mercado, Senior Partner and Empire State member, oversees a business that services over 200 small, grocery store operations.

"The beverage center goes where the franchise wholesaler fears to tread."

Like so many other Empire State members, Dee Jay plays a vital role, not only in the distribution of beer and soda, but also in providing goods and services to a community with limited resources.

Mercado graduated from the old Haaren High School in Manhattan. "My father drove a cab and did odd jobs to support the family," he said, "so there just wasn't enough money to go around for a college education." Undaunted, he tried his hand at various businesses, and finally opened his own trucking firm. By the late sixties, his income had grown to $30,000, and he felt comfortable that he was providing a good home for his wife and three children.

And then, tragedy struck. Mercado's wife became seriously ill, and the doctors diagnosed her condition as multiple sclerosis. All the family's resources were used to pay doctors' bills, hospital costs, and, finally, for a nursing home when the illness entered its terminal phase.

Mercado was heartbroken, and the enthusiasm he had in building his trucking business had left. But, with three children to support, he had to do something—something new. He scraped together $5,000, and, armed with an SBA loan, purchased his own, franchised Coca-Cola route. It was a fresh start, but it also gained him recognition in the Coca-Cola record

book as the first minority franchise route man in its history.

After working the route for almost two years, Mercado was approached by Steve Rosenthal, owner of a number of beverage centers, and the largest customer on his route. Rosenthal, one of Empire's Vice Presidents, was impressed with Mercado's determination and business acumen. Steve wanted to open another beverage center, and offered him a chance to manage it and become part owner. One hardly has to wonder why Dee Jay Beverage was opened in the South Bronx. That was almost 18 years ago. Today, Mercado has full responsibility for a business with a staff of 25, and sales of over $7,000,000 annually.

"At times, I feel like a social worker or Dear Abby, but that's just one part of the job I do for my customers."

He speaks with pride about the role Dee Jay and other beverage centers play in low-income communities. "The beverage center goes where the franchised wholesaler fears to tread," he says. "We offer same-day delivery, we're open on weekends when the storekeeper runs out, and we also function as a check cashing service for the general public," he added.

Mercado feels that being Puerto Rican, and speaking the language of the community creates a great deal of rapport with the shopkeepers. "They know I've been in business a long time and they look up to me. I give them advice on loans, licensing and new store locations," he said. "At times, I feel like a social worker on Dear Abbey," he continued, "but that's just one part of the job I do for my customers."

Jim also points out that Dee Jay and other beverage centers are an important employment ladder for minority youngsters. All of his employees are from the community. "We take kids who can't get through high school, and teach them the work ethic," he commented. "All our managers have come through the ranks, and the kids see this. Hell, they see me running the whole show, and they begin to see themselves in that same position one day."

Typical of beverage center owners, Mercado knows he has a responsibility to the community, and he sees to it that Dee Jay is heavily involved in the civic affairs of the South Bronx. "We sponsor all kinds of Little League and softball teams, as an example," he said, "and we also make major contributions to many, different community organizations." He points out that the Dee Jay philosophy is that "strong, local businesses need a viable community in order to grow and prosper."

When questioned about his unique, minority status in the beverage business, Mercado is quick to point out many other Hispanics who have

"We take kids who can't get through high school, and teach them the work ethic."

moved into ownership positions in the industry. "Our segment of the industry provides tremendous opportunities for a guy with a little money and a lot of determination," he points out. "Just look at the Bronx! We have Tommy Cuevas at House of Beers, Pablo Morales at Parkito, Rolando Lugones at Borinquen, and David Roman at Roman Beer. In Manhattan," he adds, "there is Santos Soto at East Side and Sisto Lebron at Rosa Beer. Hector Mateos, Carlos Fernandez and Peter Santiago are running profitable distributorships in Brooklyn." Pausing pensively, he mused, "The beverage centers have provided us with tremendous opportunities."

The picture, however, is not an altogether rosy one. Mercado feels that over-regulation could slow the growth of the beverage business. "With bottle bills and age restrictions, plus growing mountains of red tape, it has become increasingly difficult to make a profit. The best environment is an open and competitive one. Anything," he emphasizes, "that restricts openness is a negative."

When asked what would happen if beverage centers no longer existed, Mercado didn't hesitate. "A neighborhood business would die. The lack of competition would lead to higher prices and poorer service to my customers and friends. The employment ladder would disappear, and you'd be left with a guy from out of town delivering to the community at his convenience."

The South Bronx is an unusual place, as places go. Most people around Intervale Avenue and 163rd Street will tell you it's a lot better because Jimmy Mercado's there.

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APPENDIX

NARL OFFICERS
JOHN W. WHITE, P.D. PRESIDENT
M. JOSEPH SCHUTTE, P.D. PRESIDENT-ELECT
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CHARLES M. AKST, P.D.
EXECUTIVE VICE PRESIDENT

THE NATIONAL ASSOCIATION OF RETAIL DRUGGISTS

205 DAINGERFIELD ROAD, ALEXANDRIA, VA 22314
(703) 683-8200

2 October 1985

The Honorable Strom Thurmond
Chairman
Senate Committee on the Judiciary
SD-224 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Thurmond:

We have just learned this morning that the Committee will hold a hearing this afternoon at 3:00 p.m. on S.412, which would grant the beer industry a special exemption from antitrust laws. Judiciary staff members who contacted us today suggested that we make an appearance at the hearing this afternoon. Unfortunately, because of the short notice and longstanding commitments, we will be unable to make a personal appearance and personal presentation. As you know, under normal circumstances we welcome the opportunity to underscore our opposition to this legislation.

This legislation, commonly known as the "beer bill", would grant a special antitrust exemption to the beer industry so that agreements between brewers and wholesalers creating exclusive distribution territories would not be subject to the antitrust laws. Therefore, it would guarantee a wholesaler exclusive distribution rights for certain brands.

It is our understanding that beer wholesalers contend that this legislation is needed to clarify and codify existing law in order to avoid needless and costly litigation. Proponents of the legislation also refer to the antitrust exemption the soft drink industry (known as the "bottler's bill") received in 1980.

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The National Association of Retail Druggists concurswith the many groups, including the American Retail Federation, who oppose S.412. An antitrust exemption is hardly a clarification or codification of present law. An exemption would grant monopoly distribution rights and put retailers and their customers at the mercy of one wholesaler for each brand of beer. The inevitable result would be higher prices. There is nothing so special about the beer industry that justifies such an exemption. It is simply a bail-out from the free market system.

Equally important are the consequences that granting such an exemption would engender if this particular industry receives an exemption. It is certain other industries will soon plead the alleged merits of a monopoly on distribution rights for other commodities. Such a monopoly is antithetical to the competition and consumer savings associated with cooperative buying and related regional or multi-state cooperative advertising which are increasingly utilized by independent retail pharmacies.

In summary, the "beer bill" would raise prices, eliminate competition, restrict free enterprise, and set a bad precedent for other commodities that, likewise, may want to avoid the vigor of the free marketplace. Retailers would only be able to buy a particular brand from the assigned beer wholesalers serving a given exclusive territory; consequently, there would be no shopping for price or service.

On behalf of the owners of more than 30,000 independent pharmcies, where over 75,000 pharmacists dispense more than 70 percent of the nation's prescription drugs and serve 18 million persons daily, providing nearly 85 percent of the Medicaid pharmaceutical services, we appreciate this opportunity to reiterate our opposition to enactment of S.412.

Warm regards,

John M. Rector
Director of Government Affairs

JMR/lmu

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